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State-owned Banks Loans to Their Connected Parties: Evidence from Indonesia

Wisnu Untoro^{a*}

^aFaculty of Economics and Business, Universitas Sebelas Maret

*Corresponding author: wisnu.untoro@gmail.com

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ABSTRACT

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I hypothesize that banks' stockholders react negatively to the announcement of state-owned (government) banks loans to their connected parties. Arguably, minority shareholders may suppose that connected lending are granted for unprofitable project as state-owned banks have to help government in the social and development activities. Using data for Indonesia state-owned banks loans, I find little evidence that market reacts negatively to the loans which are granted to connected parties.

Keywords:

State-owned banks
Connected loans
Loan announcement
Minority shareholders
Indonesia

INTRODUCTION

Literature on the information content of related party transactions is well documented (e.g. Mosebach, 1999; Boscailon and Ho, 2005; Ongena et al., 2008; Huang et al., 2011). There are two competing hypotheses to explain the information content of related party transaction. Those who bolster the information view hypothesis argue that related party transactions indicate positive signal as banks have private information

about the borrowers. On the contrary, the proponents of tunneling or expropriation hypothesis contend that controlling shareholder might expropriate the granted loans to fulfill its interest (Huang et al., 2011). Most studies have measured the information content of related party transactions on the borrower side.

The present paper undertakes to investigate the information content of connected lending on the lenders (banks) side. Particularly, I analyze market reaction to state-owned (government) banks loan announcements to their related and non-related parties. Indonesian state-owned banks (henceforth SOBs) are appropriate objects for this research because a number of Indonesian SOBs have been partially privatized through selling shares on the stock market (publicly traded). However, the Indonesian government maintains its majority ownership.

I argue that market would react negatively to the announcements of connected loan¹ of such banks. Based on development or social view of government banks, those banks sometimes are tasked to release lending to fund unprofitable investments. Therefore, negative reaction might be resulted from the connected loan announcements. According to the grabbing hand theory, it could also be supposed that market might react negatively. A growing body of literature has introduced the political theory of government ownership of banks explaining that state-owned banks (SOBs) are less profitable because they have to serve the interests of politicians (La Porta et al., 2002) as opposing theory of the development theory of SOBs. The literature on political view of public enterprises has been growing since the seminal work of Shleifer and Vishny (1994, 1998) which introduce the concept of “grabbing hand” that bureaucrats/ politicians extract resources from such firms under their control such as shown by excess employment and wages. Several studies have empirically attempted to examine the grabbing hand theory on SOBs by arguing that lending of SOBs increases in general election years to fulfill the needs of politicians who are running in the election (Dinc, 2005; Micco et al., 2007).

This present study undertakes to investigate how banks' stockholders react to the announcement of state-owned (government) banks loans to their connected parties using the difference method with such previous studies. Arguably, minority shareholders suppose that connected lending are granted for unprofitable project as state-owned banks have to help government in the social and development activities. Moreover, I also argue that the negative reaction could indicate the existence of the grabbing hand behaviors.

In this study, I use loans announcement of SOBs to examine the existence of grabbing hand. Therefore, I analyze the reaction of lenders' (SOBs) shareholders rather than the market value of borrowers. I hypothesize that market would react negatively to the announcement of SOBs loans to their connected parties.

METHODOLOGY

I obtain data of 83 Indonesian SOBs loan announcements IPOTNEWS Database (cross checked by looking at the corporate action announcements published by Indonesia Stock Exchange and by tracing on banks' websites). 31 loans are granted to connected parties.

¹ I define the connected parties of Indonesian state-owned banks are state-owned enterprises which majority owned by the Indonesian government or their subsidiaries.

Event study

To test the market reaction to the loan announcement, I employ event study analysis using market model. I calculate abnormal return using market model with windows period during 3 days (1 day before and after the date of announcement), 7 days (3 days before and after the date of announcement), 11 days (5 days before and after the date of announcement) The estimation period for 100 days.

Determinants of Abnormal Return

Going deeper to investigate the determinants of abnormal return around the announcements date, I estimate an empirical model as follows:

$$CAR = f(\text{Connected Loan, Loan Characteristics, Borrower Specific-factors, Bank Specific-factors}) \dots\dots\dots (1)$$

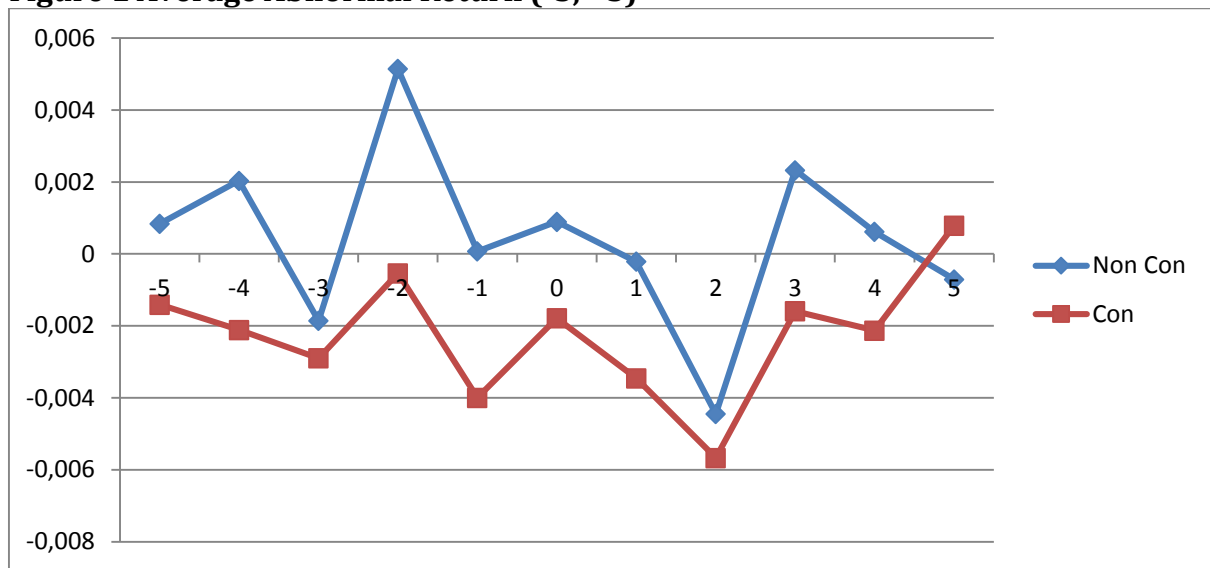
$$CAR = \alpha_0 + \alpha_1\text{CONN} + \alpha_2\text{AMOUNT} + \alpha_3\text{SYNDICATED} + \alpha_4\text{ROA} + \alpha_5\text{AGE} + \alpha_6\text{SIZE} + \alpha_7\text{LISTED} + \alpha_8\text{REGIONAL} + \varepsilon \dots\dots\dots (2)$$

Table 1 Measure of Variables

Variable	Measure
Dependent Variable	
CAR	Cumulative abnormal return during the event (window period - 5, +5; -3, +3, -1,+1)
Loan Characteristics	
CONN	Dummy variable (1 = loan to connected party, 0 = otherwise)
AMOUNT	Amount of Loan (Ln amount of loan, all loans are standardized in US\$)
SYNDICATED	Dummy variable (1 = syndicated loans, 0 = otherwise)
Borrower Factors	
ROA	Return of borrower (Return on Asset t-1)
AGE	Age of the borrower (year)
SIZE	Size of borrower (Ln Total Assets t-1)
LISTED	Dummy (1 = Borrowers are publicly traded firms)
Bank Factors	
REGIONAL	Dummy (1 = Loans are issued by regional state-owned banks)

EMPIRICAL RESULTS

Figure 1 Average Abnormal Return (-5, +5)



The results of event study are presented in Figure 1. The average abnormal return of connected loans during the windows period (-5,+5) is lower than non-connected loans, except for the t+5. It indicates that market (minority shareholders of state-owned banks) reacts negatively to announcement of connected loans.

Table 2 presents the descriptive statistics of variables. The mean of CAR 1, CAR 3, and CAR 5 are -0.003, -0.003 and 0.003, respectively. 36.2 % of loans are granted to connected loans. 47.8% of loans are syndicated loans. Table 3 exhibits the correlation matrix of variables. As expected, connected loans (CONN) is negatively correlated with either CAR 1, CAR 3, or CAR 5.

Table 2 Descriptive Statistics

	CAR1	CAR3	CAR5	CONN	AMNT	SYNDC	ROA	AGE	SIZE	LISTD	REGNL
Mean	-0.003	-0.003	0.003	0.362	18.332	0.478	7.390	31.043	22.351	0.739	0.043
Median	-0.006	-0.006	0.003	0.000	18.603	0.000	3.730	26.000	22.064	1.000	0.000
Maximum	0.099	0.095	0.113	1.000	20.924	1.000	35.940	110.000	25.304	1.000	1.000
Minimum	-0.088	-0.104	-0.144	0.000	15.174	0.000	-4.050	2.000	19.848	0.000	0.000
Std. Dev.	0.031	0.039	0.048	0.484	1.380	0.503	8.110	21.874	1.165	0.442	0.205
Skewness	0.023	0.014	-0.107	0.573	-0.242	0.087	1.635	1.703	0.483	-1.089	4.477
Observations	69	69	69	69	69	69	69	69	69	69	69

Table 3 Correlation Matrix

	CAR1	CAR3	CAR5	CONN	AMNT	SYNDC	ROA	AGE	SIZE	LISTD	REGNL
CAR1	1.000										
CAR3	0.587	1.000									
CAR5	0.282	0.754	1.000								
CONN	-0.154	-0.166	-0.097	1.000							
AMOUNT	-0.083	0.025	0.078	0.389	1.000						
SYNDICATED	-0.178	-0.082	0.029	0.123	0.404	1.000					
ROA	0.075	0.023	-0.029	0.138	0.250	-0.049	1.000				
AGE	-0.156	-0.095	0.029	0.433	0.139	-0.161	-0.012	1.000			
SIZE	0.085	0.049	0.078	0.407	0.595	0.028	0.250	0.212	1.000		
LISTED	0.171	0.030	0.061	-0.582	-0.283	-0.224	0.201	-0.339	0.016	1.000	
REGIONAL	-0.038	-0.093	0.023	-0.013	0.018	0.223	-0.056	-0.053	-0.052	-0.035	1.000

Table 4 Regression Results

The values in parentheses are standard errors corrected using White robust method. *, ** and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

	CAR 1	CAR 3	CAR 5
CONN	-0.01 (0.012)	-0.027* (0.015)	-0.019 (0.019)
AMOUNT	-0.003 (0.004)	0.0008 (0.005)	0.003 (0.007)
SYNDICATED	-0.01 (0.009)	-0.008 (0.012)	0.002 (0.015)
ROA	0.0003 (0.0005)	0.0003 (0.0007)	-0.0003 (0.0008)
AGE	-0.0003 (0.0002)	-0.0002 (0.0003)	0.0002 (0.0003)
SIZE	0.006 (0.005)	0.006 (0.006)	0.004 (0.008)
LISTED	-0.005 (0.013)	-0.02 (0.016)	0.002 (0.02)
REGIONAL	0.0004 (0.019)	-0.014 (0.024)	0.005 (0.03)
Constant	Included	Included	Included
Observations	69	69	69
R-squared	0.103	0.084	0.04

Table 4 is the results of OLS estimations. Surprisingly, I do not find evidence on the impact of control variables on cumulative abnormal return during windows period. However, the effect of connected loans is found to be negative significant when I use CAR 3 (-3,+3). It means that minority might have felt that the connected loans of state-owned banks to their connected parties are unprofitable either for social and development projects or for the self-interest of bureaucrats and politicians.

CONCLUSION

I argue that banks' minority stockholders would react negatively to the announcement of state-owned (government) banks loans to their connected parties. Arguably, minority shareholders suppose that connected lending are granted for unprofitable project as state-owned banks have to help government in the social and development activities. By studying 83 loans of Indonesian state-owned banks, I find little evidence that market reacts negatively to the loans which are granted to connected parties.

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